Nos. 80-1012, 80-1030, 80-1052

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In the Supreme Court

OF THE

United States

OCTOBER TERM, 1980

BAXTER RICE, Director, Department of Alcoholic Beverage Control of the State of California,
Petitioner,

vs.

NORMAN WILLIAMS COMPANY, et al.,
Respondents.

BOHEMIAN DISTRIBUTING COMPANY,
Petitioner,

vs.

NORMAN WILLIAMS COMPANY, et al.,
Respondents.

WINE & SPIRITS WHOLESALERS OF CALIFORNIA,
a California corporation,
Petitioner,

vs.

NORMAN WILLIAMS COMPANY, et al.,
Respondents.

On Petitions for Writ of Certiorari to the Court of Appeal of the State of California, Third Appellate District

CONSOLIDATED BRIEF IN OPPOSITION TO PETITIONS FOR CERTIORARI

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QUESTIONS PRESENTED

1. Should this Court review a state court decision invalidating a state statute, where that decision was based on a finding that the state had no regulatory interest in the statute?

2. Is there a *per se* violation of the Sherman Act when two parties agree to prohibit a third party from importing liquor which the latter has legally purchased outside the state?

3. Has not *California Retail Liquor Dealers' Ass'n v. Midcal,* 445 U.S. 97 (1980) (*"Midcal"*), established that the Sherman Act preempts a state liquor statute under which, without any valid regulatory purpose, the state expressly authorizes and enforces a *per se* violation of the Sherman Act by private parties?

4. Given *Midcal,* may a state rely upon the Twenty-first Amendment to justify enforcement of private agreements between distilling companies and selected wholesalers which bar otherwise legal importation by other licensed wholesalers?

5. Does the "state action" exemption to the Sherman Act insulate from preemption a California statute which, without provision for any state review or supervision, allows private distilling companies to prohibit wholesalers from engaging in interstate commerce?

6. Should this Court review a state court decision invalidating a state statute which is not only fundamentally unfair, but also unconstitutional on independent federal grounds, including:

a. The state statute deprives a state-licensed liquor importer of due process in violation of the Fifth and Fourteenth Amendments because it delegates to another private party the virtual power to revoke the importer's license

without specifying any criteria or standards and without providing for a hearing, review or appeal.

b. The state statute deprives state-licensed liquor importers of equal protection of the law in violation of the Fourteenth Amendment because it discriminates on the basis of consent from a private party.

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I

STATEMENT OF THE CASE AND SUMMARY OF ARGUMENT

In the proceeding below,[1] the California Court of Appeal

[1]Opinion reported at *Norman Williams Co. v. Rice*, 108 Cal. App. 3d 348, 166 Cal. Rptr. 563 (1980).

invalidated California Assembly Bill (A.B.) 499,[2] which would have delegated to private distillers the power to determine who may import liquor into California. Under the statute, "designation" agreements between a distiller and his chosen California wholesaler would have prohibited other fully licensed wholesalers from importing liquor lawfully purchased from a source other than the distiller. Discerning no state regulatory interest to justify such an anticompetitive restriction, the state court found that A.B. 499 was inconsistent with and preempted by the federal antitrust laws. The California Supreme Court refused to review or disturb this decision.

The state court's decision was compelled by this Court's unanimous decision in *California Retail Liquor Dealers' Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980) (hereinafter *"Midcal"*). *Midcal* has settled the law in this area, and the instant case presents issues almost identical to those presented in *Midcal*. Just as it was a *per se* violation of the Sherman Act in *Midcal* for the fair trade statute to give a brand owner of wine the power to set minimum retail prices for the brand in California, it is a *per se* violation for A.B. 499 to empower a brand owner of liquor to prohibit a wholesaler from importing branded liquor which has been legally purchased from a third party. In fact, A.B. 499 goes beyond fair trade in its anticompetitive effect: the distiller has more than the mere power to control the prices; he can actually decide who can compete. Applying the interest-balancing test prescribed in *Midcal*, the state court found no state interest which counterbalanced the statute's blatant interference with the national policy in favor of competition.

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[2]Cal. Stats. 1979, Ch. 280 § 1, amending Cal. Bus. & Prof. Code § 23672.

Contrary to Intervenors'[3] contentions, *Midcal* and long established principles of preemption confirm that there is no "right" to enact a state liquor statute inconsistent with the Sherman Act, particularly where (as here) the state's own courts have determined that the statute is utterly devoid of a valid state regulatory purpose. By distorting the meaning of certain dictum in *Midcal* in such a way that the dictum swallows the holding, the Intervenors attribute unlimited sweep to the Twenty-first Amendment and predict that the decision below will create uncertainty and confusion regarding the validity of laws similar to A.B. 499 in other states. In fact, *Midcal* was a strong statement that the scope of state power under of the Twenty-first Amendment is limited by the Sherman Act. *Midcal* held that the Amendment did not save fair trade from preemption, but one would think from reading the Intervenors' petitions that *Midcal* had come out the opposite way. *Midcal* requires that state and federal interests must be balanced on a case-by-case basis, and gives great weight to a state court's evaluation of the relative interest of the state.

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[3]As in *Midcal*, the Petitioners pressing this Court to second-guess the state court's finding of no state interest include private parties who intervened in the proceedings below and who represent the very importers who would be unfairly benefited if the distillers were allowed to erect barriers to free interstate competition (hereinafter referred to as "Intervenors"). Because the California courts could discern no valid state interest in the statute, it is also questionable whether the petition filed by the California Attorney General truly represents the interests of the state. In fact, the commitment of Respondent Baxter Rice, Director of Dept. of A.B.C. of the state, to this statute is dubious since he neither sponsored nor supported this measure in the state legislature. Because the State Attorney General and the state courts are at odds on this matter, the brief of he Attorney General is largely addressed to the balance and separation of powers between the California courts and the California legislature, an issue certainly inappropriate for this Court to consider.

Under the *Midcal* rule, the lower courts may now balance the respective interests in each particular case. There is thus no need for this Court again to address its attention to the overall balance between the Twenty-first Amendment and the Sherman Act, nor is there need for it to strike the balance in each case, particularly where, as here, the state court itself could discern no valid state regulatory interest.

The Intervenors also unsuccessfully attempt to suggest something worthy of this Court's time in the purported inconsistency between the decision below and *Grant-Billingsley Wholesale Liquor Co. v. Lennen*, 49 U.S.L.W. 3331 (11/3/80), hereinafter *"Grant-Billingsley,"* dismissed by this Court for want of a substantial federal question. Because *Midcal* has specified that the lower courts are to balance federal interests and state interests on a case-by-case basis, the fact that a court has balanced these interests in the Kansas regulatory context differently from a California court in the radically different California regulatory environment hardly means that there is inconsistency in the fundamental law to be applied.

The Intervenors also futilely attempt to attack the state court's opinion on the basis of a remarkable misreading of *Continental T.V. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977). Citing *Sylvania,* they contend that the state court erred in concluding that A.B. 499 authorizes a *per se* violation of the Sherman Act. While it is correct that *Sylvania* abolished the *per se* rule against territorial restrictions imposed by a manufacturer on his own franchisee-distributor, *Sylvania* does not empower a distiller to do what A.B. 499 authorizes: to enter into agreements which prohibit

interstate commerce by *a third party* in goods purchased neither from the distiller nor his franchisee. Although a distiller may impose reasonable territorial restrictions on his own franchisees and terminate a franchisee who violates such restrictions, nothing in *Sylvania* authorizes a distiller or his franchisee to prevent the interstate movement of goods by a third party who has legally purchased those goods outside the franchise system.

The statute amended by A.B. 499 originally was part of California's fair trade apparatus. In *Rice v. A.B.C. Appeals Bd.*, 21 Cal. 3d 431, 146 Cal. Rptr. 585, 579 P. 2d 476 (1978) (hereinafter *"Rice"*), the California Supreme Court held that California's liquor fair trade laws were preempted by the Sherman Act. Although review of *Rice* was never sought in this Court, the reasoning in *Rice* was subsequently endorsed by this Court in *Midcal,* which invalidated California's wine fair trade laws. *Rice* did not scrutinize § 23672, but the Director of the California Department of ABC decided that *Rice* rendered the original version of § 23672 unenforceable because the power to designate was delegated to the party posting the fair trade prices, a party which, after *Rice*, could not exist legally.

Respondents (Petitioners below) are wholesalers and retailers of distilled spirits. The wholesaler Respondents are fully licensed by the state to import. Prior to *Rice*, these wholesalers had never been able to import major national brands (which constitute 90% of California consumption) because they had never been designated as importers under § 23672 by the oligopoly of big distillers (e.g., Seagram, Hiram Walker, Heublein, Schenley) who produce or market such major brands. After *Rice*, however, the wholesaler Respondents began to purchase the major brands for importation in Oklahoma, whose law requires distillers selling spirits in that state to sell to all licensed Oklahoma wholesalers, who, in turn, may resell to "qualified persons"

outside the state, such as the Respondents. Oklahoma, in other words, has a "no franchise" rule, and provides a fully legal source of major national brands outside the franchise system.

Respondents and the Oklahoma wholesalers observe all reporting, regulatory and tax requirements of the States of Oklahoma and California and of the U.S. Bureau of Alcohol, Tobacco and Firearms as to the interstate movement of this liquor. These rules and requirements are, in fact, exactly the same as those applied to sales of liquor by the distillers to their franchisees. As noted in the opinion below, the only significant difference is that the Respondent wholesalers sell to licensed retailers in California at prices significantly below those charged by the designated or franchised wholesalers, who invariably charge the prices "suggested" by the distillers. A.B. 499, however, would have resurrected the power which the distiller formerly had under fair trade to exclude such discounting wholesalers from the state. One practical effect of A.B. 499, then, would be to insulate the franchised wholesalers from the only true price competition they presently face. It is, in short, fair trade though the back door.

II

ARGUMENT

A. THE COURT BELOW CORRECTLY CONCLUDED THAT THE DESIGNATION STATUTE WOULD ENFORCE PRIVATE CONDUCT WHICH IS PER SE VIOLATIVE OF THE SHERMAN ACT

In an opinion firmly anchored in *Midcal*, the California Court of Appeal ruled that A.B. 499 is preempted by the Sherman Act because the state statute would authorize and enforce a *per se* violation of the Sherman Act. A state may not allow, authorize or enforce private agreements or

practices which are *per se* illegal under the Sherman Act. *Schwegmann Bros. v. Calvert Distillers Corp.*, 341 U.S. 384, 386-89 (1951); *Rice*, 579 P.2d at 482.[5]

1. Effect of the Designation Process on Competition

It is important to understand the operation and effect of a designation under A.B. 499. The statute contemplates that each distiller or brand owner would agree with one or more California importers or wholesalers to sell his brand to the wholesaler and to authorize the wholesaler to import the brand into California. In the absence of the statute, such an agreement between a distiller and a wholesaler would have no effect on importers who could legally obtain the same brand from some source other than the distiller, such as an Oklahoma wholesaler.

By operation of A.B. 499, however, anticompetitive consequences result from such a private agreement. If the distiller entered into designation agreements with one or two wholesaler-importers and did nothing else, the legal consequence would be that all other wholesaler-importers would be prohibited from importing the brand, even if they may lawfully obtain the brand without restriction from someone other than the distiller. The statute does more than merely recognize the distiller's right to sell to whomever he pleases. It transforms his agreement to designate and sell to an importer into an *automatic* prohibition on importation by others of goods in which the distiller has no property right or ownership interest. The statute *requires* the distiller

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[5]*Schwegmann* invalidated a Louisiana fair trade law which allowed but did not compel liquor distributors to impose minimum prices. *Joseph E. Seagram & Sons v. Hostetter*, 384 U.S. 35 (1966), relied upon by Intervenors, does not overrule or modify this aspect of *Schwegmann*. Bohemian erroneously contends that the state court below did not find a *per se* violation. The state court in fact held that A.B. 499's delegation to a private party of the power to forbid interstate commerce was in "direct contravention of the express terms of . . . the Sherman Act." 166 Cal. Rptr. 570.

to enter into designation agreements. The *necessary* effect of a designation agreement under the statute is to exclude non-designated importers. The State of California would enforce this exclusionary agreement by private parties.

A designation agreement between a distiller and a designated California importer is thus a naked restraint on interstate commerce between two other parties, an Oklahoma wholesaler and another California importer, who in a free market would be legally able to import liquor into California. In other words, private parties would be allowed and empowered by the State to enter into agreements which exclude others from the market.

2. Designation Agreements Should Be Prohibited by a Per Se Rule

This Court has delineated some general tests and criteria for determining whether to apply the *per se* rule to anticompetitive practices. In *Northern Pacific Railway Co. v. U.S.*, 356 U.S. 1, 5 (1958), the Court held that *per se* illegal practices under the Sherman Act are those "which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use." Another definition of *per se* violations was stated in *White Motor Co. v. U.S.*, 372 U.S. 253 at 263, 9 L. Ed. 2d 738, 746, 83 S. Ct. 696 (1963): "naked restraints of trade with no purpose except stifling of competition." In *National Society of Professional Engineers v. U.S.*, 435 U.S. 679, 692 (1978), practices were said to be *per se* illegal if their "nature and necessary effect are so plainly anticompetitive that no elaborate study of the industry is needed to establish their illegality."

Applying the above guidelines for *per se* rules to designation agreements, it is readily apparent that no elaborate

industry analysis is required to demonstrate the unequivocal anticompetitive character and operation of a designation agreement. The statute requires designations, and the necessary effect of designation is the outright exclusion of "non-designated" wholesalers who could otherwise legally compete. The theoretical possibility that a distiller may designate all importers licensed by the state should not remove designation agreements from the category of *per se* violations. As this court observed in *Catalano, Inc. v. Target Sales,* ..... U.S. ....., 64 L. Ed. 2d 580 at 586 (1980):

> "In any event, when a particular concerted activity entails an obvious risk of anticompetitive impact with no apparent potentially redeeming value, the fact that a practice may turn out to be harmless in a particular set of circumstances will not prevent its being declared unlawful *per se.*"

A.B. 499 certainly contemplates that the distiller will designate less than 100% of the importers licensed by the state.[6] Otherwise, the statute would have been totally superfluous.

In general, an agreement between two or more parties depriving a third party of a source of supply is a *per se* violation. For example, in *Klor's, Inc. v. Broadway-Hale Stores, Inc.,* 359 U.S. 207 (1959), a retailer's agreement with manufacturers of electrical appliances not to sell to the retailer's competitor was found to be *per se* illegal. Another "group boycott" case, *U.S. v. General Motors,* 384 U.S. 127, 148 (1966), provides a closer parallel to the

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[6]In *Joseph E. Seagram & Sons, supra,* relied upon by Petitioners, the shoe was on the other foot. There this Court found no preemption because the possibility of conflict between federal and state law was "entirely too speculative." 386 U.S. at 46. Here the possibility of no conflict is entirely speculative.

designation procedure in its anticompetitive effect. There, a group of Chevrolet dealers complained to General Motors about certain discount houses who were obtaining new Chevrolets from other Chevrolet dealers and selling them at extremely competitive prices. The first group of dealers obtained GM's agreement to prohibit the second group of dealers from reselling cars to the discounters. The Court noted that such a course of conduct was a "classic" restraint of trade, since it deprived the second group of dealers of their freedom to deal with the discounters if they so chose. 384 U.S. at 140. A designation agreement has exactly the same effect as the latter agreement, since the legal consequence of designation is to deprive the Oklahoma wholesalers of their freedom to sell to discounters in California who are competing with the designee.

> "Exclusion of traders from the market by means of combination or conspiracy is so inconsistent with the free-market principles embodied in the Sherman Act that it is not to be saved by reference to the need for preserving the collaborators' profit margins. . . . The protection of price competition from conspiratorial restraint is an object of special solicitude under the antitrust laws. We cannot respect that solicitude by closing our eyes to the effect upon price competition of the removal from the market . . . of a class of traders. Nor do we propose to construe the Sherman act to prohibit conspiracies to fix prices at which competitors may sell, but to allow conspiracies or combinations to put competitors out of business entirely." 384 U.S. at 146-48.

See also Cernuto Inc. v. United Cabinet Corp., 595 F.2d 164 (3rd Cir. 1979).

The designation statute is likewise analogous to certain established *per se* violations where competition is excluded

through an exclusionary membership policy in a trade association. For example, in *Associated Press v. U.S.*, 326 U.S. 1 (1945), each of the 1,200 newspaper members of the Associated Press had the right under the Association's by-laws to veto the admission of its business competitor. Since the by-laws also prohibited sale of the Association's wire service to non-members, it was very difficult for a non-member to buy news. These exclusionary by-laws were found to be a *per se* violation. As in the *Associated Press* case, a wholesaler in the present case must become part of "the club"—i.e., he must be "designated"—before he can effectively compete.

The Intervenors misleadingly attempt to shoehorn designation agreements into the thoroughly eroded rule in *U.S. v. Colgate,* 250 U.S. 300 (1919). They contend that A.B. 499 merely confirms the unilateral right of each distiller to refuse to sell his brands to the Respondents. Such unilateral refusals are, of course, not judged under *per se* rules. However, the issue here is not, as the Intervenors erroneously contend, the freedom of the distillers to refuse to sell to Respondents, but whether the distillers should be allowed to prohibit Respondents from purchasing from a third party. Without A.B. 499, Respondents may lawfully acquire liquor from third parties in Oklahoma and import it into California despite the distillers' refusal to sell directly to them. Respondents do not contend that federal law requires that the distillers sell directly to them. Respondents have a source of supply independent of the distillers, with which A.B. 499 would allow the distillers to interfere. In other words, A.B. 499 is not designed to allow the distiller to dispose freely of his own property; it allows him to interfere with someone else's free disposition of *his* own property.

3. Respondents Need Not Show That the Operation of the Statute Fits Exactly into a Previously Established Per Se Violation

The state court did not establish a new *per se* violation; it simply concluded that designation fell under the already well-delineated *per se* rule against agreements which "deprive others of access to merchandise which the latter wish to sell to the public." *U.S. v. General Motors, supra,* 384 U.S. at 146.

It is the ultimate in legal formalism to suggest that designation must be on all fours with a *particular* previously defined *per se* violation before it can be found to be inconsistent with the Sherman Act. This Court has made it quite clear that there is no immutable list of *per se* illegal practices. The Sherman Act is to be applied flexibly to whatever anticompetitive devices and artifices are created through the ingenuity of those who believe they can reap gains by insulating themselves from competition. *National Society of Professional Engineers v. U.S., supra,* 435 U.S. 679, 688 (1978).

This Court has continued to give shape to the mandate of the Sherman Act by identifying anticompetitive practices which fit into the category of conduct which is so exclusionary as to be deemed illegal without further inquiry, most recently in *Catalano, Inc., et al. v. Target Sales, Inc., supra,* ..... U.S. ....., 64 L. Ed. 2d 580 (1980). Were lower courts constrained to apply *per se* rules only in situations where the practice under consideration was on all fours with some particular previously defined *per se* violation, antitrust violators could easily evade the law by slight modifications to practices previously declared illegal.

4. Sylvania Condones Restrictions Only on Franchisees, Not on Third Parties Outside the Franchise System

In a futile attempt to demonstrate that designation agreements are not a *per se* violation, the Intervenors argue that designation is analogous to territorial restrictions on franchisees, dealt with in *Continental T.V., Inc. v. GTE Sylvania, Inc., supra,* 433 U.S. 36 (1977) (hereinafter *"Sylvania"*). In that case, the Court held that a territorial restriction imposed by a manufacturer on his franchisee should be judged under the rule of reason analysis rather than a *per se* rule. The Court found that such restrictions, while they concededly impaired intra-brand competition (between Sylvania's distributors), *may* have redeeming benefits.[7]

A.B. 499 is not analogous to *Sylvania,* because A.B. 499 restrictions act on different parties than do *Sylvania* restrictions. The rule of reason in *Sylvania* may well allow a distiller to prohibit his own franchisee from reselling his brand to a third party in another state. But if branded goods are legally available to a third party from a non-franchisee (e.g., an Oklahoma wholesaler), *Sylvania* does not allow the manufacturer to go to the border and directly prohibit such a third party from carrying the goods over state lines. A.B. 499 authorizes the latter type of prohibition on a third party who is outside the franchise system.

Sylvania, in other words, stands for the principle that a manufacturer may impose reasonable territorial restrictions on the operations *of his own franchisee* as a con-

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[7]*Sylvania* did not find such restrictions to be *per se* legal. Such restrictions may still violate the Sherman Act if they in fact unreasonably restrain trade and provide no demonstrable benefit to interbrand competition.

dition to selling to that party directly. Should the franchisee violate such restrictions, the manufacturer may terminate the franchise. Such restrictions may be imposed on franchisees without A.B. 499. *Sylvania,* however, does not give the distiller any direct power *over third parties* dealing in goods which have left *or never entered* the franchise system. If such third parties may legally obtain the manufacturer's goods in spite of the manufacturer's restrictions on his franchisees (or may obtain goods from wholesalers who, like the Oklahoma jobbers, are not franchisees), *Slyvania* creates no remedy against the interstate movement of such goods in the hands of such third parties.[8]

Although the distillers object to Oklahoma's "no-franchise" rule, they nonetheless find it profitable to market their brands in Oklahoma. Having chosen to enter the Oklahoma market, they have put their goods beyond their own franchise system and its restrictions. Oklahoma jobbers may freely and legally resell the goods to third parties like Respondents. Having voluntarily let the goods leave the franchise system, the distillers may not now seek in *Sylvania* a justification for erecting barriers at state lines to commerce in such goods by third parties who are not franchisees and who have obtained the goods without contractual restriction.

Sylvania can provide no support for the validity of A.B. 499 for the additional reason that the designation process automatically imposes restrictions which are industry-wide rather than narrow and selective as in

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[8]Neither does *Adolph Coors Co. v. A&S Wholesalers,* 561 F.2d 807 (10th Cir. 1977), cited by the Attorney General, create such a remedy. In that case, a preliminary injunction obtained by a brewer against a non-franchisee transporting the brewer's brand in interstate commerce was found to be wrongful and was dissolved. 561 F.2d at 809, 811.

Sylvania. *Sylvania* involved a restriction on intrabrand competition imposed by a single company which was struggling to maintain a 1-2% share of the national television market against strong interbrand competition from RCA and others. 433 U.S. at 38. The designation process is, however, not narrowly targeted to benefit only those competitors who actually need it to strengthen themselves in interbrand competition. A.B. 499 would be an industry-wide restriction on intrabrand competition for all brands and companies, weak and strong, including such entrenched giants as Seagrams, with 20% of the national market. Such giants hardly need to be strengthened as interbrand competitors.[9]

5. There Are No Redeeming or Pro-competitive Benefits from A.B. 499

While the exclusionary effects of designation agreements are obvious, it is equally obvious that there are no counterbalancing benefits from the statute which would warrant removing it from the *per se* illegal category. The California Court of Appeal's opinion noted that the designation process does not serve any of the purportedly noble goals or purposes conjured up by the Intervenors to justify it, such as monitoring of imports, facilitation of tax auditing (see below pp. 29-30), the prevention of integration of the manufacturing and wholesaling functions (see below pp. 19-20), the preservation of small retailers, or the promotion of temperance.

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[9]For example, territorial restrictions were found to be unreasonable and illegal in *Eiberger v. Sony Corp.*, 622 F.2d 1068 (2d Cir. 1980), where it was said that Sony's market share of 12% in dictating equipment "completely undercuts" its argument that vertical restrictions were necessary to strengthen the company in interbrand competition. *Id.* at 1081.

Erroneously invoking the policy considerations discussed in *Sylvania,* Intervenors claim that the restrictions which A.B. 499 imposes in int*ra*brand competition will promote int*er*brand competition and that, because of this redeeming virtue, A.B. 499 should not be judged under a *per se* rule. Intervenors' argument is essentially that the exclusion of discounting importers and the consequent maintenance of high prices will encourage the franchisees to undertake promotional and advertising activities. This argument ignores the fact that one of the express purposes of the California Alcoholic Beverage Control Act is the promotion of temperance. Cal. Bus. & Prof. Code § 23001. Since more advertising carries the danger of encouraging more drinking, there can be no merit to the claim that the legislature intended to encourage more advertising.

The other possible kinds of enhancement of interbrand competition involved in *Sylvania* are likewise absent here. *Sylvania* dealt with the television industry, where it is important to product quality to encourage franchisees to invest in facilities for warranty service. 433 U.S. at 55. The reputation of a brand of television often depends on the easy availability of such services. While it may be important to protect a television dealer from intrabrand competition from discounters who sell the television but do not provide the warranty services, such services are totally unnecessary in the liquor industry. No one needs warranty service on his Scotch bottle.

The *factual* contention that suppression of int*ra*brand price competition in the California liquor industry would in any way enhance int*er*brand competition was specifically considered by the California Supreme Court in *Rice.* Based on detailed statistics and other evidence as to past prices, that Court concluded that suppression of intrabrand price competition actually *impaired* interbrand price competition in the California liquor market. In fact,

the California Supreme Court concluded that uniform intrabrand pricing for liquor tends to encourage uniform interbrand pricing. 579 P.2d at 491-2, 21 Cal. 3d at 454-56.[10] Because of high concentration in the distilling industry in America and the huge market shares held by the major national brands, the encouragement of vigorous intrabrand competition is clearly important.

B. THE STATUTE IS NOT SAVED FROM PREEMPTION BY THE TWENTY-FIRST AMENDMENT OR THE STATE ACTION EXEMPTION

1. An Interest-Weighing Analysis Should Be Used

In deciding that A.B. 499 was not saved from preemption by the Twenty-first Amendment, the California Court of Appeal again reached a result compelled by *Midcal*. While the states obviously possess a large measure of control over the regulation of liquor, *Midcal* holds that state and federal powers over liquor must be harmonized in an interest-weighing analysis where "the national policy in favor of competition" is balanced against the state's own regulatory interests. *Midcal*, 445 U.S. at ....., 63 L. Ed. 2d at 240. The courts of the State of California itself have concluded that while A.B. 499 would completely undermine the policies embodied in the Sherman Act, it at the same time would serve *no* legitimate state regulatory goals. As noted in *Midcal*, great weight should be given to the state court's evaluation of the relative regulatory interest of the state in such statutory programs. 445 U.S. at ....., 63 L. Ed. 2d at 247.

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[10] *Sylvania* does not hold that suppression of intrabrand competition will automatically enhance interbrand competition. To the contrary, the *Sylvania* court held that the degree of intrabrand competition and interbrand competition is totally independent. *Sylvania*, 433 U.S. at 52 n. 19. Each case must be analyzed on its own facts.

The balance struck by the state court is reinforced by California Constitution Article XX, § 22, which expressly acknowledges the supremacy of federal interests over state interests in the regulation of importation of liquor into California:

> "The State of California . . . *subject to the laws of the United States regulating commerce between foreign nations and among the states* shall have the exclusive right and power to regulate the importation into and the exportation from the State, of alcoholic beverages."[11] (Emphasis added)

Any interest-weighing analysis under *Midcal* must take into account the California Constitution's own acknowledgment of the preeminent federal power in this area. But the significance of Art. XX, § 22, goes even further. If a California statute regulating the importation of liquor is inconsistent with the Sherman Act, the federal statute must prevail as a matter of California law. Art. XX, § 22 of course gives the lie to Intervenors' contention that California can claim a "right" to enact a statute like A.B. 499, which is inconsistent with a federal statute enacted under the Commerce Clause. Even if California can be said to have such a "right" under Federal law, it has specifically waived this right in its own constitution.

2. The Midcal Dictum

Despite its inconsistency with the Sherman Act and with the provisions of Article XX, § 22, the Intervenors nonetheless maintain that A.B. 499 is saved from preemption by the Twenty-first Amendment. In making this contention they have seized upon the following dictum from the *Midcal* opinion:

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[11]Article XX, § 22, was adopted by initiative on November 8, 1932, *after* Congress had passed the Twenty-first Amendment.

> "The Twenty-first Amendment grants the States virtually complete control over whether to permit importation or sale of liquor and how to structure the liquor distribution system." *Midcal, supra*, 445 U.S. at ....., 63 L. Ed. 2d at 246.

Intervenors claim that the present case is distinguishable from *Midcal* because A.B. 499 purportedly concerns whether to permit importation and how to structure the distribution system, while the wine fair trade statutes invalidated in *Midcal* concerned some other aspect of regulation. In essence, Intervenors argue that the *Midcal* balancing test is not to be applied to statutes which in any way concern importation or distribution.

In interpreting this dictum, the California court believed that the reference to a state's "virtually complete control over *whether to permit importation or sale*" self-evidently refers only to the power of the state to prohibit the importation or sale of liquor *entirely*, 108 Cal. App. 3d at 359, 166 Cal. Rptr. at 570. One of the primary purposes of the Twenty-First Amendment was to allow a state to remain dry if it so chose. 76 CONG. REC. 4141 (remarks of Sen. Blaine, sponsor of the amendment in the Senate). The state court justifiably concluded that once a state has decided to allow the importation and sale of liquor by private parties, the Twenty-first Amendment cannot justify a blatantly anticompetitive scheme of regulation which furthers no legitimate state regulatory purpose. In such a case, the state's regulatory interest, here considered by the state court to be unsubstantiated, is outweighed by the pro-competition goals of the Sherman Act. 108 Cal. App. 3d at 359, 166 Cal. Rptr. 573.

Neither can A.B. 499 be defended as an attempt to "structure the liquor distribution system." This language in *Midcal* obviously reconfirms that a state has the power to

adopt such "structures" as a state monopoly, *see, e.g., Midcal*, 445 U.S. at ....., 63 L. Ed. 2d 243 n.9, or a "three-tier system," i.e., separate and independent ownership of the manufacturing tier, the wholesaling tier, and the retailing tier. However, the relation of A.B. 499 to "structure" is remote at best. The principal claim that the statute is "structural' in nature is that it is designed to preserve the three-tier system. Rejecting this contention, the California court found that, by giving the distillers more control over the wholesale level, the statute is actually counterproductive to the state's goal of preventing integration of manufacturers and wholesalers. 166 Cal. Rptr. at 571 n.11. Without A.B. 499, the free importation of Oklahoma liquor allows at least some wholesalers to be truly independent of the distillers, as contemplated in the three-tier requirement. While the three-tier requirement, which exists in California law independently of A.B. 499, is obviously directed at "structure," A.B. 499 is not. Excluding certain independent competitors at the wholesale tier does not "structure" a three-tier system, nor does it effectuate any other type of "structure."

Intervenors' reliance on the Twenty-first Amendment is also misplaced because that amendment is directed to guaranteeing the *state* a place in regulating interstate commerce in liquor. The present case involves not the state itself as a regulator but a private system of regulation, which is unsupervised by the state. See below pp. 21-22 and 25-27.

If the *Midcal* dictum indeed means that the *Midcal* preemption analysis does not apply to statutes pertaining to distribution and importation, as Intervenors contend, the dictum would swallow the holding in *Midcal*. Certainly, the fair trade statute in *Midcal*, which made it illegal to sell except at a specified price, was a measure affecting distribution. In fact, the *Midcal* opinion itself recognized that one of the principal *purported* purposes of the fair trade stat-

utes (which they did not achieve) was to preserve a distribution system of small retailers from price competition from large discount houses. *Midcal*, 445 U.S. at ....., 63 L. Ed. 2d at 248. Likewise, the wine price maintenance statutes invalidated in *Midcal* also regulated the terms of importation,[12] because these statutes empowered out-of-state suppliers of wine to control retail prices in California for their brands when imported into the state. Because *Midcal* itself dealt with a statute directed at certain aspects of distribution and importation, it is readily apparent that Intervenors' reading of the *Midcal* dictum is far too expansive.

3. The State Action Exemption

Having dealt with the Twenty-first Amendment, the court below proceeded to the issue of whether A.B. 499 was saved from preemption by the "state action exemption" to the antitrust laws. *Midcal* held that this exemption would not be triggered unless there was some active supervision by the state with respect to the regulatory scheme. The A.B. 499 regulatory scheme, as held by the court below, cannot be construed to be state action. The state has simply delegated regulation to private parties without providing standards for the regulation of competition and without overseeing or reviewing in any way the choices made by the private parties.[13]

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[12]Cal. Bus. & Prof. Code § 24867, required out-of-state brand owners of wine to "designate in writing one licensee who imports the brand of wine to make and file a fair trade contract . . . ." Although this section was not explicitly at issue in *Midcal*, it was in effect invalidated by *Midcal*.

[13]Intervenors argue that there is a possibility that such active supervision may be provided by the state in the future in the form of amplifying regulations. However, the Director of the California Department of ABC has already issued regulations pertaining to A.B. 499 (Appendix F to Wine & Spirits Wholesalers' petition), and

Intervenors' argument that the state court's decision will become precedent for declaring all state licensing schemes unconstitutional is totally without merit. State-administered licensing schemes are of course immune from Sherman Act preemption if the licensing authority is the state itself and not unsupervised private delegates.

C. GRANT-BILLINGSLEY HAS CREATED NO CONFUSION OR INCONSISTENCY IN THE LAW

Intervenors erroneously attempt to find authority for their position in this Court's dismissal of the appeal in *Grant-Billingsley*. Whatever similarity the issues in *Grant-Billingsley* may have to the present case, the dismissal of the appeal in *Grant-Billingsley* for want of a substantial federal question is not entitled to the same precedential value or "deference given a ruling after briefing, argument, and a written opinion." *Caban v. Mohammed*, 441 U.S. 380, 391 n.9 (1979).[14] In view of this, there is no danger that *Grant-Billingsley* will have the effect of blurring the clear, strong and complete statement of the law made by this Court in *Midcal*.

The general rule that dismissals of appeals have little precedential weight should apply with particular force here because an examination of the briefs in support of the motion to dismiss in *Grant-Billingsley* confirms that

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these regulations contained no provision for supervision or review by the state of the private designation agreements. Because there is no indication that the Director will issue further regulations, this Court should not consider this purely hypothetical possibility that the infirmities in the statute may be cured.

[14]Similarly, in *Edelman v. Jordan*, 415 U.S. 651, (1974) this Court held that a summary affirmance, while of some precedential value, was "obviously . . . not of the same precedential value as would be an opinion of this court treating the question on the merits." 415 U.S. at 671. *See also Massachusetts Board of Retirement v. Murgia*, 427 U.S. 307 (1976).

that motion was argued largely on the basis of the factual record in that case. Moreover, the Kansas and California courts arrived at radically different evaluations of their own state's regulatory interest in the respective statutes.

Grant-Billingsley involved an appeal from a decision of the Kansas Supreme Court upholding over a Sherman Act challenge a Kansas state liquor statute which requires exclusive territorial brand franchises. The Kansas Supreme Court opinion, *sub nom. Colby Distributing Co., Inc. v. Lennen,* 227 Kan. 2d 179, 606 P.2d 102 (1980), deals not with the Kansas Primary Source Law but with this exclusive territorial franchise provision. The opinion analyzed the latter statute in relation to the peculiar conditions of the Kansas market. Based on the factual record in the Kansas trial court, the Kansas Supreme Court saw the statute as a cure to some of the purported inefficiencies of the prior Kansas system of regulation, which had involved price control (a fixed markup) at the wholesale level, an apparent duplication of inventories and higher costs.

It was precisely this factual record and the peculiarities of the Kansas market which were argued to this Court as justification for dismissing the appeal in *Grant-Billingsley.* The Attorney General of Kansas argued that Kansas, the state of Carey Nation, had perhaps the strongest prohibitionist tradition and nearly the *lowest consumption of alcohol per capita* of any state. California is at the opposite extreme, with per capita consumption nearly twice that of Kansas. A mostly rural state with low consumption like Kansas obviously has different regulatory problems than California. The optimum way to encourage vigorous interbrand competition in these two markets can be critically different. In Kansas it may be difficult to ensure a wholesaler a profitable volume unless he has an

exclusive territory, something that is not true in California.[15] Citing *Midcal,* the appellees in *Grant-Billingsley* argued that this Court should defer to the state court findings as to a state's regulatory interest.

In *Midcal* this Court had noted that it customarily accepts the factual findings of state courts as to the state's regulatory interest in the absence of "exceptional circumstances." 445 U.S. at ....., 63 L. Ed. 2d at 247. One crucial difference between the present case and *Grant-Billingsley* is the result of the state court's own evaluation of the state's regulatory interest in the statutes concerned. In the present case, as in *Midcal,* the state courts could identify no California regulatory interests served by the statute. On the other hand, the Kansas court in *Grant-Billingsley* had found, on the basis of the factual record before it, that the Kansas statute was achieving a valid legislative purpose. Obviously, uniformity of decision does not require that California find a valid regulatory interest in A.B. 499 merely because a Kansas court did so in relation to a Kansas statute. Moreover, the State of Kansas has no state constitutional provision analogous to California Constitution Art. XX, § 22, whereby California acknowledges that its power to regulate the importation of liquor is "subject to" federal statutes enacted pursuant to the Commerce Clause.

There is no danger that lower courts will perceive the law in this area as confused. The present case and *Grant-Billingsley* are in fact a vivid demonstration of this Court's ruling in *Midcal* that the balance between federal and state regulatory interests must be analyzed on a case-by-case basis. It is predictable under *Midcal* that different statutes

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[15]Appendices to the motion to dismiss of the Kansas Attorney-General presented detailed statistics which purported to establish the actual effect of the exclusive franchise provision.

in different states may produce different results. *Midcal* certainly did not intend to stamp uniformity among states with differing regulatory problems.

The differing factual findings and evaluations of the state's regulatory interest by the state courts of Kansas and California are not binding on each other. While the California court's opinion is persuasive and well reasoned, other state courts are free, as was Kansas, to make their own evaluation of their own state's regulatory interest in its liquor statutes.

D. DEPRIVATION OF DUE PROCESS

Even if this Court believes that there is, after *Midcal*, any uncertainty as to the proper balance between the Sherman Act and the Twenty-first Amendment, the present case is not a proper vehicle for clarifying the law of preemption in liquor regulation. This is because there are fundamental constitutional infirmities in A.B. 499 which extend considerably beyond its inconsistency with the Sherman Act. Because the present case was decided so soon after the *Midcal* decision and because it bears such a close resemblance to *Midcal*, the state court had strong reasons for anchoring its opinion solely in *Midcal*. However, the state court's opinion notes at several points the basic unfairness of allowing one group of businessmen to exclude their competitors. See, e.g., 166 Cal. Rptr. at 569, 570, 572. Such a private system of regulation tramples upon numerous constitutional guarantees. A.B. 499 violates both the Fifth and Fourteenth Amendments in that it denies both due process and equal protection of the law. Since the result below may be affirmed on these grounds, *Washington v. Yakima Indian Nation*, 439 U.S. 463, 476 n.20 (1979), it would not be appropriate for this Court

to grant certiorari for the purposes of dealing with the law of preemption.[16]

A.B. 499 delegates the power to regulate importation to distilling corporations who have their own selfish interests with respect to the licensing of importers. These private parties are granted a power which they would not have absent the statute, namely the power to prevent an importer properly licensed by the state from importing goods which that importer has legally obtained in another state. This power may be exercised simply by refusing to designate an importer as "authorized." The statute, moreover, provides for no supervision or control by the state over the distillers' exercise of this delegated power. The state has thus given to private parties a virtual veto over its licensing process.

If the power to license importers is to be delegated to the distillers, due process requires that it be delegated in such a way as to protect prospective importers from arbitrary or capricious refusals to license. Since A.B. 499 superimposes a second tier of private licensing over the state's licensing process, the designation procedure should be subject to the same due process requirements otherwise applicable to the granting or revocation of liquor licenses. *Hornsby v. Allen,* 326 F.2d 605, 609 (5th Cir. 1964), con-

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[16]There is still another federal ground supporting the result below which this Court will have to consider if certiorari is granted: that A.B. 499 was preempted by Section 5a of the Federal Alcohol Administration Act, [27 U.S.C. § 205]. Respondents also argued that California Const. Art. XX, § 22 (quoted above, p. 18) flatly prohibits *any* delegation to private parties of the power to regulate importation, and that A.B. 499 violates the due process and equal protection provisions of the California Const. Even if this Court reversed the decision below it would be appropriate to remand to the state court for consideration of these independent state law grounds.

firmed that due process applies to the granting or denying of liquor licenses, and this Court reconfirmed in *Midcal*, 445 U.S. at ....., 63 L. Ed. 2d at 245, that the Twenty-first Amendment does not remove liquor regulation from due process scrutiny. A.B. 499 violates due process in the following respects:

1. In *Gibson v. Berryhill*, 411 U.S. 564, 578-79, (1973), this Court found a denial of due process in a statute which, like A.B. 499, delegates the power to license to persons with a "substantial pecuniary interest" in the licensing process. 411 U.S. at 578-79.

2. A.B. 499 provides absolutely no regulatory criteria to limit the private delegate in his exercise of the power to designate. A distiller is free under the statute to refuse to designate on arbitrary or capricious grounds. *National Cable Television v. U.S.*, 415 U.S. 336, 342 (1974).

3. The statute fails to require a hearing or opportunity for review or appeal for an aggrieved importer who has been refused designation.

E. DENIAL OF EQUAL PROTECTION

A.B. 499 is also invalid because it discriminates between two groups of licensed distilled spirits importers. The two groups involved, i.e., wholesalers who are designated to import by the distillers and those who are not, are functionally indistinguishable from a regulatory standpoint. Both have been licensed by the state to import and have thus already met the minimum standards required by the state for importers. The only distinction between the two groups is whether they are in the good graces of another private party. Nonetheless, A.B. 499 permits "designated" importers to import major brand liquor into the state while denying the same privilege to all other licensed importers. This harsh line bears no relationship to an actual and legitimate legislative purpose.

This discrimination is so utterly devoid of any legitimate regulatory purpose that it cannot pass constitutional muster, even under the "rational basis" standard of review. The rational basis standard is not "toothless." *Trimble v. Gordon,* 430 U.S. 762, 767 (1977). In fact, in *Hornsby v. Allen, supra,* the rational basis standard was used to invalidate a similarly unfair liquor licensing statute. To like effect, *Midcal* summed up the law in this area by noting that states cannot "insulate the liquor industry from the Fourteenth Amendment's requirements of equal protection." 445 U.S. at ....., 63 L. Ed. 2d at 245.

Numerous courts have confronted the precise issue of whether statutory discrimination between franchisees (i.e., "designees") and non-franchisees violates equal protection. Applying the "rational basis" standard of review to statutes which prohibited non-franchisees from selling new cars, *Joyner v. Centre Motor Co.,* 191 Va. 627, 66 S.E.2d 469 (S. Ct. App. Va. 1951); *Nelsen v. Tilley,* 137 Neb. 327, 289 N.W. 388 (S. Ct. Neb. 1939); *Rebsamen Motor Co. v. Phillips,* 226 Ark. 146, 289 S.W.2d 170 (S. Ct. 1956), found that such statutes unconstitutionally bestowed a special privilege on one class of businessmen.

> "The vice in and resultant unconstitutionality of this legislation is that it presupposes that unenfranchised dealers constitute a class who alone are capable of fraudulent and sharp practice, and that dealers who hold franchises are immune from and incapable of committing the wrongs and dishonest acts sought to be guarded against." *Joyner, supra,* 66 S.E.2d at 473-74.

Since no standards or criteria are specified in A.B. 499 for the choice of designees, it is difficult to see how designation will serve any coherent regulatory goal. Intervenors, however, argue that A.B. 499 has a rational basis

because it facilitates the tracing of imported distilled spirits and auditing for excise taxes. The legislative history of the statute is devoid of any reference to such an *actual* statutory purpose, and it is readily apparent that the statute does not serve these functions.

The state court concluded that without A.B. 499 the California liquor industry is already subject to a monitoring and auditing system which ensures that all legitimate federal and state informational interests are fully realized.[17] This system of reports and records, without A.B. 499, provides numerous cross-checks and independent verifications by which importation and taxation can be easily monitored in exhaustive detail. These reporting requirements apply equally to liquor acquired from the primary source (the distiller) or a secondary source (such as an Oklahoma jobber).

A.B. 499 provides for no additional information or records. The language of the statute itself thus utterly fails to support Intervenors' contention that the goal was one of information or auditing. If Intervenors' argument is that eliminating some competitors will reduce the administrative burden of auditing imports, the elimination should be made by the state itself and not by self-interested members of the industry.

The Intervenors also argue that the regulatory purpose of A.B. 499 is to allow California to foreclose intrusion on its "historic" or "established" channels of distribution from Oklahoma's "open wholesaling" system.

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[17]The complex web of state and federal controls includes California Department of Alcoholic Beverage Control (ABC) regulations, 4 Cal. Admin. Code, §§ 1, *et seq.*, California State Board of Equalization (SBE) regulations, 18 Cal. Admin. Code §§ 2500, *et seq.*, and U.S. Bureau of Alcohol, Tobacco, and Firearms (BATF) regulations, 27 C.F.R. §§ 194.221, *et seq.*

The "historic" channels to which Intervenors refer are those which existed under fair trade. Because Oklahoma liquor comes fully under the control of California's comprehensive import and tax auditing system, the California court found that California has no inherent regulatory interest in forestalling the side effects of the Oklahoma system. Oklahoma liquor no more "interferes" with California's regulatory system than does liquor imported by the designated importers, as to which the same reports, controls, verifications, inspections, and audits are available. It is obvious that the only threat from Oklahoma is not to California's regulatory system but to the private system of exclusion and high prices maintained by the distillers and their franchisees.

III

CONCLUSION

The court below correctly applied well-settled principles of constitutional and antitrust law. The petitions for certiorari should accordingly be denied, particularly because independent federal grounds support the result below.

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Respectfully submitted,
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